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Republican Policy
Committee

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Legislative Notice

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No. 44

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S. 1134 — Affordable Education Act of 1999

Calendar No. 124

Reported from the Committee on Finance as an original bill on May 26, 1999, by a vote of 12-8; Minority views filed. S. Rept. 106-54.

NOTEWORTHY

- At press time, it was expected the Majority Leader would attempt to turn to the consideration of the education savings bill today, with the possible filing of a cloture petition on either the motion to proceed to S. 1134 or the bill itself [see Background].

- S. 1134 is essentially the same bill as S. 1133 of the 105th Congress, which passed the Senate in April, 1998 (the conference report was passed on June 24, 1998) and was vetoed by the President on July 21, 1998.

- S. 1134 provides some $7.7 billion (over 10 years) in tax relief for education. (Note: the revenue estimates are from last year and have not yet been updated.)

- S. 1134 expands the **education savings account** changes included in the Taxpayer Relief Act of 1997 [P.L. 105-34] by increasing the annual contribution limit for education IRAs from $500 to $2,000 for taxable years 2000 through 2003. The bill also expands the definition of qualified education expenses (currently limited to higher education) to include expenses for kindergarten through grade 12.

- The bill provides an exclusion from gross income for distributions made from a **qualified state tuition program.** Distributions must be made for qualified education expenses related to attending college (including graduate school) or vocational school.

- S. 1134 extends the current-law **section 127 tax exclusion for employer-provided education expenses** from May 31, 2000, to June 30, 2004, and permits graduate-level courses to be included in the section 127 tax exclusion from an employee's gross income for employer-provided (up to $5,250 a year) education assistance.

- The bill assists local governments in issuing bonds for **school construction** by increasing the small-issuer exception from $10 million to $15 million, provided that at least $10 million of the bonds are issued to finance public schools.

- The bill contains some $7.9 billion in offsets over 10 years. However, many of these offsets were enacted into law as part of the extender package last year. A manager's amendment will be offered to make necessary effective date and offset corrections.

BACKGROUND

Legislative History

By a vote of 59 to 41, the Senate adopted Senator Coverdell's K-through-12 Education Savings Accounts proposal as an amendment to the Taxpayer Relief Act (TRA) on June 27, 1997 (vote No. 150). The provision was included in the final budget agreement reached with the White House, but due to a last-minute veto threat from President Clinton, the language was dropped from the conference report (H.R. 2014) prior to its consideration in the House and Senate. The TRA became law with education IRAs limited to $500 per student annually, and limited to higher education expenses (see below).

The Coverdell proposal was again considered in the Senate as a freestanding bill (H.R. 2646), just prior to *sine die* adjournment. Two attempts were made to invoke cloture on the bill. On October 31, the Senate failed to invoke cloture by a vote of 56-41 (vote No. 288) and again failed to cut off debate on the measure on November 4, by a vote of 56-44 (vote No. 291). [For further details on H.R. 2646, refer to RPC Legislative Notice No. 44, issued October 29, 1997.]

The Senate passed the freestanding Coverdell bill (S. 1133) on April 23, 1998, by a vote of 56-43 (Roll Call Vote Number 102), and then approved the Conference Report on H.R. 2646 by a vote of 59-36 (Roll Call Vote Number 169). President Clinton vetoed H.R. 2646 on July 21, 1998.

On May 26, 1999, the Senate Finance Committee reported out S. 1134 (a bill nearly identical to S. 1133 of the previous year). The bill was placed on the Senate Calendar as number 124.

The House passed the Taxpayer Refund and Relief Act (H.R. 2488; 223-208; House Vote Number 333) with expanded Education Savings Accounts. Although the Senate passed a version that did not include Education Savings Accounts (July 30, 1999), ESAs were included in the conference report. President Clinton vetoed the bill on September 23, 1999.

Current Law

The Taxpayer Relief Act of 1997 provides tax exempt status to education IRAs that are established to pay for the expenses of higher education only. Contributions to an education IRA may not exceed $500 per-beneficiary annually and may not be made once the beneficiary reaches age 18. The annual $500 contribution limit is phased out ratably for contributors with modified adjusted gross income (AGI) between $95,000 and $110,000 for individuals and between $150,000 and $160,000 for joint filers.

BILL PROVISIONS

Title I– Education Savings Incentives

Expansion of Education Savings Accounts

- S. 1134 increases the annual contribution limit from $500 to $2,000 for education IRAs and expands the definition of "qualified education expenses" to include the costs of elementary and secondary education (including home schooling expenses).

- The new $2,000 limit will be in effect from January 1, 2000, through December 31, 2003. For 2004 and future years, annual contributions will revert to the $500 limit and will be limited to post-secondary education expenses.

- Qualified elementary and secondary expenses include (1) tuition, fees, academic tutoring, special needs services, books, supplies, as well as the cost of computers and other equipment incurred "in connection with the enrollment or attendance" of a student in a private or public school; and (2) room and board, uniforms, transportation and supplementary items (including after-school care), "required or provided by a school for enrollment or attendance."

- The bill removes the current age limit (i.e., age 18) for contributions made on behalf of a special needs individual. For special needs individuals, the bill also removes the current age limit (i.e., age 30) by which any remaining balance in an education IRA must be distributed.

- The bill clarifies that corporations and other entities (e.g., charitable organizations, foundations, etc.) are permitted to make contributions to an education IRA, regardless of the corporation's income for that year.

- The bill retains the current-law eligibility requirements for high-income individuals. Contributions are phased out ratably at incomes between $95,000 and $110,000 (for individuals) and $150,000 and $160,000 (for joint returns).

- These provisions provide $2.4 billion in tax relief over 10 years.

Qualified State Tuition Programs

- The bill provides for the tax-exempt treatment of funds distributed from a qualified state tuition program. Amounts distributed for the qualified education expenses of attending a college, university (including graduate school), or vocational school are not included in the gross income of the contributor (or the beneficiary) for tax purposes.

- The exclusion from gross income is not permitted in cases where a HOPE or Lifetime Learning credit is claimed on behalf of a student.

- If a parent chooses to claim a HOPE or a Lifetime Learning credit for a dependent, then the earnings portion of a distribution made to a student from a qualified state tuition program will be included in the gross income of the student.

- These provisions provide $1 billion in tax relief over 10 years.

Title II– Educational Assistance

Extension of Employer-Provided Education Assistance

- The bill extends to June 30, 2004, the current-law exclusion from an employee's gross income amounts paid or incurred by an employer for education assistance provided to the employee. The provision is scheduled to expire with respect to courses beginning after May 31, 2000.

- The bill also reinstates the tax exclusion for graduate level courses.

- The exclusion is limited to $5,250 of education assistance per employee in any calendar year.

- These provisions provide $2.6 billion in tax relief over 10 years.

Eliminate 60-month Limit on Student Loan Interest Deduction

- Current law allows certain individuals who have paid interest on qualified education loans to claim an above-the-line deduction for the first 60 months of required interest payments.

- The bill expands current law to repeal the 60 month limitation and to allow qualified individuals to take a deduction for all interest paid, subject to current law maximum deduction limits.

Tax-Free Treatment of National Health Corps Scholarships

- The bill would allow students who receive a National Health Corps scholarship to exclude the dollar value of the scholarship from their gross income for tax purposes. The tax-free treatment will be extended to scholarships received by medical, dental, nursing, and physician assistant students under the National Health Corps Scholarship Program.

- Consistent with current law, the tax-free treatment does not apply to amounts received by students to cover regular living expenses, such as room and board.

- These provisions cost $8 million over 10 years.

Title III: Liberalization of Tax-Exempt Financing Rules For Public School Construction

Small Issuer Exception for Government Bonds

- The bill increases local governments' small issuer exception to $15 million, provided that at least $10 million of the bonds are issued to finance public schools.
- Under current law, arbitrage profits earned on tax-exempt bonds must be rebated to the federal government. However, an exception (the "small issuer exception") allows local government units to issue government bonds without the arbitrage rebate requirement in order to encourage public school construction. The current limit on the small issuer exception is $10 million for government units that issue at least $5 million in bonds for public schools during the calendar year.
- These provisions cost $102 million over 10 years.

Tax-exempt Bonds for Public School Facilities

- The bill expands the current-law definition of private activity bonds to include elementary and secondary public school facilities which are owned by private, for-profit corporations pursuant to public-private partnership agreements with a state or a local education agency.

Title IV– Revenue Provisions

- A manager's amendment will be offered to fix those revenue offsets that have already been enacted into law.

ADMINISTRATION POSITION

The Administration has not commented on the current bill. In the 105th Congress, the President twice vetoed similar legislation: he vetoed H.R. 2646 (Education Savings and School Excellence Act of 1998) on July 21, 1998, and H.R. 2488 (Taxpayer Relief Act, which contained education savings accounts provisions) on September 23, 1998.

COST

The Joint Committee on Taxation projects 10-year costs for the Education IRAs to be $2.387 billion; the qualified state tuition programs provision to be $959 million; the employer-provided education assistance expansion to be $2.577 billion; and the small-issuer arbitrage rebate exception to be $102 million. Total 10-year cost is $7.917 billion.

OTHER VIEWS

Senators Moynihan, Baucus, Rockefeller, Conrad, Bryan, and Robb jointly filed Minority Views in the committee report (S. Rept. 106-54).

POSSIBLE AMENDMENTS

Manager's amendment.

Other amendments to the bill are anticipated but unknown at this time. An update to this Notice will be issued shortly to address likely amendments.

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